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IN THE

Supreme Court of the United States

OCTOBER TERM, 1945. No. [redacted] 136

H. GATES LLOYD,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1945. No. .

H. Gates Lloyd,

Petitioner

v.

Commissioner of Internal Revenue,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF.

TO THE HONORABLE, THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your Petitioner, a resident of Haverford, Pennsylvania, respectfully petitions this Court for the issuance of a writ of certiorari to the Circuit Court of Appeals for the Third Circuit, to review the judgment of that Court entered on March 4, 1946, affirming a decision of The Tax Court of the United States entered on March 22, 1945.

A certified transcript of the portions of the record before the Circuit Court of Appeals at argument including the proceedings in the Circuit Court of Appeals, to-

gether with the requisite number of copies thereof, has been heretofore furnished in conformity with Rule 38 of this Court.

JURISDICTION.

This Court has jurisdiction to review the decision of the Circuit Court of Appeals in this case under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, chap. 229, Sec. 1, 43 Stat. 938; 28 U. S. C. A. Sec. 347(a). The judgment of the Circuit Court of Appeals was entered on March 4, 1946 (R. 106).

QUESTIONS PRESENTED.

1. Whether a holder of municipal bonds who detached interest coupons from the bonds and sold the coupons prior to their maturity is subject to income tax on the proceeds of the sale.

2. Whether the imposition of income tax on the proceeds of the sale of interest coupons detached from municipal bonds is prohibited by the Constitution of the United States.

REASONS FOR GRANTING THE WRIT.

1. The Circuit Court of Appeals for the Third Circuit, in holding that the proceeds of sale of "B" Coupons detached from bonds issued by the City of Philadelphia were not exempt from tax, decided an important question of Federal law which has not been, but should be, settled by this Court; and has decided the question in a way which is not in accord with decisions of this Court establishing the applicable principles of law.

2. The decision of the said Circuit Court of Appeals is in violation of the implied constitutional prohibition against impairment of the borrowing power of the several States and of political subdivisions thereof. *Pollock* v. *Farmers' Loan & Trust Company*, 157 U. S. 429; *id.*, 158 U. S. 601.

STATEMENT OF THE MATTER INVOLVED.

This case arises under Section 22(b)(4) of the Internal Revenue Code (53 Stat. 9; 26 U. S. C. A. Sec. 22(b)(4)), which provides for exemption from Federal income tax of "Interest upon (A) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; * * *." During the year 1941 a partnership of which the Petitioner was a member shared in proceeds from the discount of interest coupons on bonds issued by the City of Philadelphia, Pennsylvania. The partnership reported its share of the proceeds as tax-exempt interest on its 1941 partnership return, and the Petitioner accordingly did not report any portion thereof as taxable income on his individual income tax return for that year (R. 74a, 75a). The Respondent determined that the proceeds from the discount of the interest coupons were not exempt from tax. He increased the income of the partnership, and increased the income of the Petitioner because of his interest in the partnership (R. 87a, 88a). The Tax Court sustained the Respondent's determination,[1] and the Circuit Court of Appeals affirmed the Tax Court (R. 106).

The City of Philadelphia in 1940 desired to refund some of its outstanding bonds in order to take advantage of low money rates then prevailing. Drexel & Co., a partnership of which the Petitioner was a member, and

[1] The decision of The Tax Court gave effect to a concession by the Respondent that a portion of the proceeds did constitute tax-exempt interest (R. 90a, 94a).

Lehman Bros. of New York City submitted a plan for the refunding of outstanding bonds of the City by exchange to a maximum principal amount of $131,064,000 (R. 78a, 79a, 80a). After consideration of several proposed plans, the City on June 9, 1941 adopted that submitted by Drexel & Co. and Lehman Bros. (R. 79a). A syndicate, known as "City of Philadelphia Refunding Bonds of 1941, Drexel & Co., Lehman Bros., Joint Account Managers" (hereinafter called "the Syndicate"), was formed to carry out the plan adopted by the City. Drexel & Co. became a member of the Syndicate (R. 76a).

The City of Philadelphia and the Syndicate entered into a contract known as the Refunding and Exchange Contract, under which the Syndicate agreed to undertake to effect the exchange of the new refunding bonds for such outstanding bonds of the City as might be surrendered in accordance with the refunding plan, and the City agreed to authorize the issuance of the new bonds (R. 79a). The City agreed to effect the exchange of bonds solely through the Syndicate, and the Refunding and Exchange Contract gave the Syndicate the right to charge holders of the old bonds, who desired to make the exchange, a fee of 1% of each new bond issued in exchange (R. 79a). The contract gave the Syndicate the right to buy and sell and otherwise deal in both the old and new bonds for its own account (R. 80a).

The refunding plan called for the refunding of bonds of various issues of the City aggregating $131,064,000, which bore interest at rates varying from 4% to 4½% and which matured at various dates from February 16, 1952, to August 1, 1977, but which were callable during the years 1942 to 1947, inclusive. Under the plan the new bonds, to be issued in series, provided for interest at the rate provided in the old bonds until the first optional call date of the old bonds, and provided for interest at reduced rates varying from 2¼% to 3¼% thereafter (R. 80a). The optional call dates of the new bonds were

later than such dates provided for in the old bonds except Series "M" which was not callable, and the maturities of the new bonds were shortened to dates between January 1, 1949, and January 1, 1973 (R. 80a, 81a).

The new bonds were issued in both coupon and registered form (R. 81a). The new bonds in coupon form had attached thereto two types of coupons designated respectively "A" and "B" (R. 81a). The "A" Coupons represented interest during the life of each new bond at the reduced rate provided for in the plan (R. 81a). The "B" Coupons represented the difference between the rate of interest of each old bond and the new reduced rate of interest, and ran from July 1, 1941, until the respective first optional call dates of the old bonds (R. 81a). The purposes of the two sets of coupons were, first, to provide for reductions in the interest rates only after the first optional call dates of the old bonds, and second, to make it possible for investors to detach the "B" Coupons and thus have instruments carrying single rates of interest which would be familiar to investors and which would enable the bonds to be traded in the market, thus providing inducements to the holders to make exchanges desired by the City (R. 81a).

The Syndicate consisted of 39 investment houses and banks located in 9 different states of the Union (R. 76a). The Syndicate arrangements were the subject of an agreement entered into by each member with Drexel & Co. and Lehman Bros. as Joint Account Managers (R. 86a).

During the year 1941 the Syndicate as Agent for the City under the Refunding and Exchange Contract effected exchanges of old bonds for new bonds, and in this connection received commissions in the amount of $367,003.25 (R. 84a). During the year 1941, the Syndicate purchased bonds of the City of Philadelphia in the face value of $15,017,400, for which the principal cost was $17,159,994.59 (R. 84a). The Syndicate during 1941 ex-

changed the old bonds which it had purchased for new bonds in coupon form, that is, with "A" and "B" Coupons attached. As sufficient blocks of bonds accumulated during the year, notice was given to members of the Syndicate that the bonds were available for sale, and notices of offerings were prepared and circulated among members of the Syndicate (R. 84a, 85a). The bonds were offered by the Syndicate without the "B" Coupons attached. Because of the impracticability of distributing the large number of varying types of coupons pro rata to each of the 39 members of the Syndicate, arrangements were made with The Philadelphia National Bank that at intervals when sufficient detached "B" Coupons were on hand, The Philadelphia National Bank would discount them on a 1¼% basis (R. 85a). During 1941 the Syndicate discounted with The Philadelphia National Bank coupons having a face value of $666,896.65 and received from The Philadelphia National Bank the sum of $647,630.38 (R. 85a). The Syndicate received the face value of "B" Coupons maturing January 1, 1942, in the sum of $15,314.22, which the Respondent conceded were tax exempt (R. 85a, 90a, 94a). During the year 1941 the Syndicate sold all of the bonds of the City of Philadelphia which it purchased and the proceeds from such sales totaled $16,517,164.46 (R. 85a, 86a). All of the City of Philadelphia bonds purchased by the Syndicate were purchased at substantial premiums above par, with the exception of a few bonds that were callable within six months on which the premium was relatively small, and all of the bonds which the Syndicate sold during 1941 were sold at substantial premiums above par (R. 86a).

Proceeds which the Syndicate received during the year 1941 from the collection and sale at discount of "B" Coupons in the amount of $662,944.60 were reported in the Syndicate's return for that year as tax exempt interest (R. 77a). The partnership of Drexel & Co. which had a 4% interest in the operations of the Syndicate

showed its share of such amount as tax exempt interest in its return for the calendar year 1941 in which the operations of the Syndicate were reflected (R. 75a). The Petitioner in his individual income tax return for the calendar year 1941 reported income from the partnership of Drexel & Co. as shown on the schedule of distributable shares of income filed with the return of Drexel & Co. (R. 74a, 75a).

The Respondent determined that the proceeds from the discount of "B" Coupons in the amount of $662,944.60 should be added to the net income of the Syndicate, and that as a result the partnership income of Drexel & Co. should be correspondingly increased because of its interest in the Syndicate, and that the Petitioner's income should be increased because of his interest in Drexel & Co. (R. 87a, 88a). At the trial in the Tax Court the Respondent conceded that $15,314.22, representing the face value of "B" Coupons maturing January 1, 1942, should not be added to the Syndicate income (R. 90a, 94a). The Respondent's contention was upheld by the Tax Court which found a deficiency in the Petitioner's income tax for the year 1941 in the amount of $3,960.98 (R. 97a). The decision of the Tax Court was affirmed by the Circuit Court of Appeals for the Third Circuit on March 4, 1946 (R. 106).

WHEREFORE, your petitioner respectfully prays that the petition be granted.

OWEN BIDDLE,
JESSE R. FILLMAN,
CASPAR W. B. TOWNSEND,
WM. CLARKE MASON,
Counsel for the Petitioner.

JUNE, 1946.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

OPINIONS BELOW.

The opinion of the Circuit Court of Appeals (R. 98-105) has not yet been reported. The opinion of the Tax Court is reported in 3 T. C. 829. It is also printed in the Record beginning at page 72a.

JURISDICTION.

The judgment of the United States Circuit Court of Appeals for the Third Circuit was entered on March 4, 1946. The jurisdiction of the Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, chap. 229, Sec. 1, 43 Stat. 938; 28 U. S. C. A. Sec. 347(a).

STATUTE INVOLVED.

Section 22 of the Internal Revenue Code (53 Stat. 9; 26 U. S. C. A. Sec. 22) provides in material part as follows:

> Gross Income—
>
> • • • • • • •
>
> (b) Exclusions from Gross Income.—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:
>
> • • • • • • •

(4) Tax-free interest.—Interest upon (A) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; * * *.

STATEMENT.

The facts upon which the Petitioner makes application for the issuance of a writ of certiorari are stated in the foregoing Petition for Writ of Certiorari. In so far as may be necessary for clear understanding of the ensuing argument in support of the Petition, these facts will be supplemented by further references to the Record.

SPECIFICATIONS OF ERROR.

The errors which the Petitioner intends to urge are that the Circuit Court of Appeals erred:

1. In holding that the Petitioner's share of the proceeds of sales by the Syndicate in 1941 of "B" Coupons not maturing until after January 1, 1942, constituted income taxable to the Petitioner.

2. In failing to hold that the proceeds of such sales constituted interest exempt from tax under Section 22 (b)(4) of the Internal Revenue Code.

3. In failing to hold that the Respondent's imposition of income tax on the proceeds of such sales effected an unconstitutional impairment of the borrowing power of the City of Philadelphia.

4. In affirming the decision of the Tax Court.

ARGUMENT.

1. The Syndicate of which the Petitioner's partnership firm was a member, detached specially designated "B" unmatured interest coupons from municipal bonds and discounted the coupons with a bank. The Court below has held that the proceeds did not constitute interest exempt from income tax under Section 22(b)(4) of the Internal Revenue Code, *supra*, page 9, but were the proceeds of "a bargain of a right to receive certain moneys in the future from the City" (R. 103). The decision below ignores an important principle of income tax law which has been established by decisions of this Court, relating to anticipatory dispositions of rights, or the evidence of rights to receive income. This Court has held that a gratuitous assignment of a right to receive income is not effective to prevent taxation of the income to the assignor (*Helvering* v. *Horst*, 311 U. S. 112), and that such an assignment made for a consideration does not change the character of the income in the hands of the transferor. *Hort* v. *Commissioner*, 313 U. S. 28. These rules are grounded upon the reasoning of numerous decisions of this Court. See for example, *Lucas* v. *Earl*, 281 U. S. 111; *Burnet* v. *Leininger*, 285 U. S. 136; *Griffiths* v. *Helvering*, 308 U. S. 355; *Harrison* v. *Shaffner*, 312 U. S. 579. The breadth and importance of the rules can be seen in their application to income in the form of interest (*Helvering* v. *Horst, supra*); to rental income upon the cancellation of a lease (*Hort* v. *Commissioner, supra*); to dividends sold (*Gibson* v. *Commissioner*, 133 F. (2d) 308 (C. C. A. 2d)); to trust income realized through the sale of a life interest (*Beulah Eaton McAllister*, 5 T. C. 714); to compensation received through the sale of stock options (T. D. 5507; I. T. 3795, Int. Rev. Bull., April 22, 1946, pp. 2, 3); to rights to in-oil payments assigned while the oil is still in place (G. C. M. 24849, Int. Rev. Bull., March 11, 1946, p. 4). See also,

Commissioner v. *Tower,* No. 317, this Term. The Court below failed to perceive the pertinence of the principle above discussed, and instead relied heavily upon *Clyde C. Pierce Corp.* v. *Commissioner,* 120 F. (2d) 206 (C. C. A. 5th) involving the unrelated situation of bonds with interest coupons in default which were purchased for a "flat price". A proper recourse to decisions of this Court leads, we submit, to the conclusion that the proceeds from the disposition of the interest coupons were interest when received and as such were exempt from income tax under the statute.

Is a taxpayer to be deprived of the exemption which attaches to municipal bond interest simply because he realizes on the interest coupon prior to its accrual? This question we submit should be answered in the negative under principles laid down by this Court.

The error in the result reached by the Court below is emphasized by the fact that the exemption in cases such as the one at bar is altogether lost. If the Petitioner is denied exemption, through the Syndicate and his partnership firm, no one will obtain any benefit from the statutory exemption because the purchaser of the coupons is entitled to recover the investment made and has no need of the exemption (except to the extent of the discount which of course was not received by the Syndicate).

The case at bar presents a question of importance in the administration of the income tax. The Syndicate consisted of 39 investment houses and banks located in 9 different states of the Union (R. 76), and consequently involves a great number of taxpayers. Aside from the number and geographical location of the taxpayers involved in the Syndicate in this particular municipal financing operation, the case assumes importance because of the recent wide use of municipal refunding plans calling for two separate series of interest coupons. The first instance of the use of such a plan appears to have been in the case of the Independent School District of Des Moines,

Iowa (R. 27a) which was adopted November 6, 1940, and made provision for the exchange of $5,140,000 of outstanding bonds for refunding bonds with two sets of coupons. The Petitioner is informed that the following political subdivisions of states have adopted plans which have made use of coupons corresponding to the A and B coupons used in the Philadelphia refunding:

Chattanooga, Tenn., June 1, 1941, to refund $6,135,000 of bonds;

County of Nassau, N. Y., July 27, 1942, to refund $5,660,000 of bonds;

Atlantic City, N. J., June 1, 1944, to refund $12,918,000 of bonds;

Township of North Bergen, Hudson County, New Jersey, May 1, 1945, to refund $5,533,000 of bonds;

Margate City, Atlantic County, N. J., June 1, 1945, to refund $2,306,000 of bonds.

In each of the above plans, the Petitioner is informed that provision was made under which one set of the coupons could be detached so as to provide instruments carrying a single rate of interest which was one of the purposes of the provision in the Philadelphia refunding.

2. In the circumstances of the case and of the refunding plan of the City of Philadelphia out of which the case arises, it is submitted that the imposition of income tax upon the proceeds from the disposition of the interest coupons imposes a burden upon the power of the City to borrow money and destroys a substantial measure of protection which is intended to be afforded the municipality under the Constitution. *Pollock* v. *Farmers' Loan & Trust Company,* 157 U. S. 429; *id.,* 158 U. S. 601. As the record shows, the City was enabled to refund many bonds which but for the operations of the Syndicate would not have been offered for exchange (R. 28a, 29a). The tax imposes a direct burden upon the refunding operations of the City and is therefore invalid under the Constitution.

CONCLUSION.

The case at bar presents an important question in the administration of income tax law which was incorrectly decided by the Court below and which should be decided by this Court. A substantial question of the constitutionality of the imposition of the tax involved is also presented. The petition should therefore be granted.

Respectfully submitted,

OWEN BIDDLE,
JESSE R. FILLMAN,
CASPAR W. B. TOWNSEND.
WM. CLARKE MASON,
Counsel for the Petitioner.

JUNE, 1946.

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In the Supreme Court of the United States

OCTOBER TERM, 1946

No. 136

H. GATES LLOYD, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court of the United States (R. 72a–97a)[1] is reported in 4 T. C. 829. The opinion of the Circuit Court of Appeals (R. 98–105) is reported in 154 F. 2d 643.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on March 4, 1946. (R. 106.) The petition for a writ of certiorari was filed on June

[1] The record references are to the Appendix to the brief for petitioner filed in the Circuit Court of Appeals. The Clerk of the Third Circuit has certified that the record in the case is in his office. (R. 106.)

3, 1946. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Where municipal bonds are purchased and shortly thereafter unmatured coupons are detached and sold separately though almost simultaneously with the resale of the bonds, are the proceeds exempt from tax as "interest" within the meaning of Section 22 (b) (4) of the Internal Revenue Code?

2. Assuming that the proceeds from the sale of the unmatured detached coupons do not constitute "interest," are they exempt from tax under the Constitution?

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from * * * sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; * * *

* * * * *

(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

* * * * *

(4) *Tax-free interest.*—Interest upon (A) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; * * * Every person owning any of the obligations enumerated in clause (A), (B), or (C) shall, in the return required by this chapter, submit a statement showing the number and amount of such obligations owned by him and the income received therefrom, in such form and with such information as the Commissioner may require. * * *

* * * * *

(26 U. S. C. 1940 ed., Sec. 22.)

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

* * * * *

(26 U. S. C. 1940 ed., Sec. 111.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.22 (b) (4)–1. *Interest upon State obligations.*—Interest upon the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia is exempt from the income tax. Obligations issued by or on behalf of the State or Territory or a duly organized political subdivision acting by constituted authorities empowered to issue such obligations, are the obligations of a State or Territory or a political subdivision thereof. Special tax bills issued for special benefits to property, if such tax bills are legally collectible only from owners of the property benefited, are not the obligations of a State, Territory, or political subdivision. The term "political subdivision," within the meaning of the exemption, denotes any division of the State or Territory which is a municipal corporation, or to which has been delegated the right to exercise part of the sovereign power of the State or Territory. As thus defined, a political subdivision of a State or Territory may or may not, for the purpose of exemption, include special assessment districts so created, such as road, water, sewer, gas, light, reclamation, drainage, irrigation, levee, school, harbor, port improvement, and similar districts and divisions of a State or Territory.

STATEMENT

Most of the facts were stipulated. The stipulation and the exhibits attached were incorporated

by reference in the Tax Court's findings of fact (R. 74a–88a), which may be summarized as follows:

The taxpayer was a member of Drexel and Company, a banking partnership (R. 75a), which in turn was a member of a syndicate (R. 76a) which entered into an agreement with the City of Philadelphia for refunding various bond issues of the city (R. 79a). In the agreement the syndicate agreed to undertake to effect the exchange of new refunding bonds for such old outstanding bonds of the city as might be surrendered in accordance with the terms of the plan, and the city agreed to authorize the issuance of such new refunding bonds. (R. 79a.)

The plan called for the refunding of bonds of various issues aggregating about $131,000,000, which bore interest at rates varying from four percent to four and one-half percent and which matured at various dates from 1952 to 1977, but which were callable at the option of the city during the years 1942 to 1947, inclusive. Under the plan, the new bonds provided for interest at the rate provided in the old bonds until the respective first optional call dates of the old bonds, and bore interest at reduced rates varying from two and one-fourth percent to three and one-fourth percent thereafter. The new bonds, with the exception of one series, were callable at the option of the city during the years 1948 to 1958, inclusive,

and matured at different dates from 1949 to 1973. (R. 80a–81a.)

The new refunding bonds were issued by the city in both coupon and registered form. The bonds issued in coupon form had attached thereto two types of coupons designated, respectively, "A" and "B". The A coupons represented interest during the life of each new bond at the reduced rate provided for in the plan. The B coupons represented the difference between the new reduced rate of interest and the rate of interest of each old bond, and ran from July 1, 1941, until the respective first optional call dates of the old bonds. The purpose of the two sets of coupons was, first, to provide for a reduction in the interest rate only after the respective first optional call dates of the old bonds, and second, to make it possible for investors to detach the B coupons and thus have instruments carrying a single rate of interest which would be familiar to investors and which would enable the bonds to be traded in the market, thus providing inducement to the holders to make the exchanges desired by the city. (R. 81a.)

Under the contract between the city and the syndicate, the latter was given the right to deal in both the old and the new bonds for its own account. (R. 80a.) Pursuant to this provision, the syndicate during the taxable year purchased old bonds at a cost of about $17,159,000 (R. 84a),

exchanged them for new bonds (R. 84a–85a), detached the B coupons, sold them for about $647,000 (R. 85a) and sold the new bonds with the A coupons attached for about $16,517,000 (R. 85a–86a). As a result of these transactions, the syndicate in its income tax return reported a loss of about $642,000 and treated the proceeds from the sale of B coupons in the amount of about $662,000 as tax-exempt interest. (R. 77a.)

Upon the audit of the return of the syndicate, the Internal Revenue Agent in Charge determined that the "proceeds from discount of 'B' coupons" in the amount of about $662,000 should not be considered as tax-free interest. This action resulted in changing Drexel and Company's "distributive share of the syndicate tax exempt interest," and also in increasing the taxpayer's partnership income in the amount of about $5,800. (R. 87a–88a.) These determinations of the Revenue Agent were adopted by the Commissioner in the latter's determination of the deficiency in this case. (R. 88a.)

The Tax Court decided that in determining the partnership's distributive share of the income of the syndicate and taxpayer's distributive share of the income of the partnership, the proceeds from the discount of B coupons are not tax-free interest within the meaning of Section 22 (b) (4) of the Internal Revenue Code, but must be considered along with the selling price of the new bonds with

the A coupons attached in determining the gain or loss from the entire transaction; and that any gain resulting from the purchase and exchange and sale of the bonds is to be included in gross income under Section 22 (a) of the Internal Revenue Code. The taxpayer appealed to the Circuit Court of Appeals for the Third Circuit, which affirmed the decision of the Tax Court.

ARGUMENT

1. The petitioner does not allege that the decision of the court below is in direct conflict with the decision of another Circuit Court of Appeals, and not one of the decisions of this Court to which the petitioner refers involves the same statutory provision or similar facts.

The decision of the court below, which affirmed the unanimous decision of the Tax Court,[2] is correct. The principal question in the case is whether the proceeds from the sale of the unmatured B coupons detached from City of Philadelphia bonds and sold separately constitute "interest" within the meaning of Section 22 (b) (4) of the Internal Revenue Code, *supra*. Inasmuch as Section 22 (b) (4) exempts interest on certain obligations from the federal income tax, it must be strictly construed; exemptions from taxation cannot rest upon mere implication. See *United States* v. *Stewart*, 311 U. S. 60, 71..

[2] The Tax Court's decision was reviewed by the entire court. (R. 97a.)

This Court has had occasion to define the term "interest" and has held that interest is the amount which one has contracted to pay for the use of borrowed money; the amount actually paid during the taxable year as interest; compensation paid for the use of money. See *Deputy* v. *duPont*, 308 U. S. 488, 497–498; *Old Colony R. Co.* v. *Commissioner*, 284 U. S. 552, 560–561.[3] Compare *Equitable Society* v. *Commissioner*, 321 U. S. 560, 564. The proceeds from the sale of the B coupons could not qualify under this definition of "interest," because under the circumstances of this case the syndicate did not lend the City of Philadelphia money for any appreciable period of time. The purchase of old bonds, exchange of old for new bonds, detachment of B coupons, sale of B coupons to one party and sale of the new bonds with A coupons to another party, all took place "almost simultaneously." (R. 90a.) Therefore, there was no opportunity for interest to accrue on money lent.[4] The Tax Court so held (R. 91a), and the court below agreed (R. 103).

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[3] While this Court was construing the word "interest" as used in Section 23 of the Revenue Act or the corresponding provision of earlier Revenue Acts in these cases, there is no reason to believe that the term would not have the same meaning in Section 22 of the Internal Revenue Code.

[4] The case does not present the question of the treatment of accrued interest in case of a sale of bonds between interest dates where the sale agreement specifies a division. (See R. 91a–94a.)

The petitioner relies upon a number of decisions of this Court relating to anticipatory dispositions of rights, or the evidence of rights to receive income. (Br. 11.) None of these cases, however, involves the construction of the word "interest" in Section 22 (b) (4) and none involves facts similar to those in this case. The only case cited by the petitioner which involves the disposition of unmatured bond coupons is *Helvering* v. *Horst,* 311 U. S. 112. In that case the taxpayer detached coupons from his bonds and gave them to his son just before maturity and his son collected the proceeds of the coupons. The question was whether the proceeds of the coupons constituted income to the donor-taxpayer, not whether they constituted interest. That case differs materially from this case where the syndicate sold the newly acquired bonds to one party and the coupons to another before interest had accrued on the coupons; the real question in this case is whether the proceeds from the *sale* of the coupons represented part of the proceeds of the bonds.

The Tax Court decided, and the court below agreed, that the proceeds from the sale of B coupons represented a return of capital. The substance of the transaction was that the syndicate bought outstanding bonds for $17,159,994.59, exchanged those bonds for new bonds, detached the B coupons, sold the B coupons for $647,630.38, sold the new bonds with A coupons attached for

$16,517,164.46. (R. 84a–86a.) All of these transactions took place almost simultaneously. (R. 90a.) As a result of these transactions, the syndicate claimed a loss of $642,830.13, representing the difference between the amount it paid for the outstanding bonds and the amount it received for the new bonds with A coupons attached. The proceeds from the sale of B coupons, namely, $662,944.60, were treated as tax-exempt interest. (R. 77a.) But the Commissioner determined, the Tax Court held, and the court below agreed, that the proceeds from the sale of the B coupons represented part of the return of capital and therefore must be added to the sum of $16,517,164.46, representing the proceeds from the sale of new bonds with only A coupons attached. Clearly, the fact that the B coupons were detached and disposed of separately cannot alter the substance of the transaction. While there is no court decision directly in point, there is an analogous decision which tends to support the decision of the Tax Court and of the court below. See *Clyde C. Pierce Corp* v. *Commissioner,* 120 F. 2d 206 (C. C. A. 5th).

As the court below held, whether the issue is regarded as one for independent judgment of the reviewing court or one in which judicial review is limited by the principles established by *Dobson* v. *Commissioner,* 320 U. S. 489, and *Kelley Co.* v. *Commissioner,* decided January 7, 1946, not yet

reported, the decision of the Tax Court was properly affirmed.

2. The petitioner assigns as another reason for granting the writ in this case that the imposition of income tax upon the proceeds from the sale of B coupons imposes a burden upon the power of the city to borrow money and destroys a substantial measure of protection which is intended to be afforded a municipality under the Constitution. (Br. 13.) If the proceeds from the sale of the B coupons are interest, no constitutional question arises because they are exempt from tax under Section 22 (b) (4) of the Internal Revenue Code. If, however, they represent part of the proceeds from the sale of the new bonds, as the Tax Court and the court below decided, then they are not interest. They are not exempt under Section 22 (b) (4), and this Court has held that they may constitutionally be subjected to income tax to the extent that they represent a gain from the sale of property.[5] *Willcuts* v. *Bunn*, 282 U. S.

[5] In support of the petitioner's argument, he cites *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429, on rehearing, 158 U. S. 601. Since, for the reasons stated in *Willcuts* v. *Bunn*, *supra*, the *Pollock* case is entirely inapplicable, it is unnecessary to consider the question of the continued authority of the *Pollock* case. We think it proper to point out, however, that in our view this Court has rejected the reasoning of the *Pollock* case and has expressly overruled the principal authorities upon which it was predicated. *N. Y. ex rel. Cohn* v. *Graves*, 300 U. S. 308; *Hale* v. *State Board*, 302 U. S. 95, 107; *O'Malley* v. *Woodrough*, 307 U. S. 277; *Graves* v. *N. Y. ex rel. O'Keefe*, 306 U. S. 466.

216; *United States* v. *Stewart*, 311 U. S. 60. Since these cases seem to be controlling, there is no substantial constitutional question presented by the facts of this case.

CONCLUSION

There is no direct conflict of decisions. The decision of the court below is correct, and no substantial constitutional question is presented. Therefore, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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